

COMPLIANCE SECTION



2001 M Street, N.W.
Washington, D.C. 20036

**Report on Compliance and on Internal Control Over Financial Reporting
Based on an Audit of Financial Statements Performed in Accordance
with *Government Auditing Standards***

To the Members of the Emergency Transition Education Board of Trustees
and the Members of the Board of Education of the District of Columbia

We have audited the financial statements of the District of Columbia Public Schools (DCPS) as of and for the year ended September 30, 2000, and have issued our report thereon dated January 26, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As a part of obtaining reasonable assurance about whether the DCPS' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* which are described in the accompanying schedule of findings as items 00-1 and 00-2.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered DCPS internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect DCPS' ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings as items 00-3, 00-4, 00-5, 00-6, 00-7, 00-8, 00-9, 00-10 and 00-11.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 00-5, 00-10, and 00-11 to be material weaknesses.



This report is intended solely for the information and use of the Emergency Transition Education Board, the Board of Education, management, the District's Office of Inspector General, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

January 26, 2001

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00-1: Delinquent Single Audit Reports

DCPS is delinquent in filing its fiscal year 1998 and 1999 Single Audit Reports as required by OMB Circular A-133, *Audits of States, Local Governments and Nonprofit Organizations*. The US Department of Education (DOE) granted extensions of time for filing both the 1998 and 1999 A-133 audit reports; however, DCPS did not file the reports within the extended periods. In addition the delinquent reports, once filed, may show a significant increase in questioned costs. Questioned costs had increased from \$326,123 per the fiscal year 1997 single audit to a DCPS estimate of \$1,114,853 for fiscal year 2000.

Criteria:

Per OMB Circular A-133 Section 320(a), DCPS is required to submit its reporting package including its A-133 audit reports within 13 months of the end of the audit period.

Cause:

Completion of the fiscal year 1997 audit was delayed pending acceptance of the 1995 and 1996 A-133 audit. The 1998 A-133 audit was not completed to allow for timely filing with the Federal Clearing House.

Effect:

- DCPS is in violation of the filing requirements under OMB Circular A-133, Audits of States, Local Governments and Non Profit Organizations.
- Accrued liabilities for questioned costs are based on estimates instead of audited financial information.

Recommendation:

DCPS should take the necessary action to ensure that its 1998 and 1999 A-133 audits are completed expeditiously and submit its reports to the Federal Government.

Management's Response:

DCPS' Management concurs with this finding. DCPS' A-133 audits for fiscal years 1998 and 1999 are delinquent because of two factors: 1) Quality Control Review (QCR) was performed by the Department of Education (DOE) on the fiscal year 1995 A-133 audit of DCPS and 2) delays by the firm hired to perform DCPS' audits.

As a result of the QCR, the DOE required the auditors to perform additional audit work and the revised fiscal year 1995 report was not issued to DCPS until May 27, 1999. In July 1999, the DOE Office of the Inspector General requested the auditors' workpapers for the 1996 audit in order to perform a QCR on the 1996 audit. DOE later rescinded its request for a QCR for the 1996 audit.

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However, completion of the fiscal year 1997 audit was delayed pending acceptance of both the 1995 and 1996 audits and the District Government, through the Inspector General, requested a waiver of time for the submission of DCPS' single audit report for October 30, 1997. DOE granted an extension until April 29, 1999.

The District awarded those audits to an accounting firm that experienced serious internal management problems during the course of performing the DCPS CAFR and A-133 audits. The firm's restructuring and extensive changes of the staff assigned to the engagement resulted in delays in completing DCPS' fiscal 1998 and 1999 A-133 audits. Through the intervention of the District's Inspector General, the firm was required to complete the audits by the end of February 2001.

Questioned costs have increased because supporting documents were not readily available to compute a reliable estimate. We have since located most of the documents and believe that the questioned costs will be significantly reduced when we complete this process and the final calculation is made.

00-2: Missing Employee Files

During our audit of personnel files, we noted that one or more key documents were missing from employees' Official Personnel Folders (OPF) maintained in the Human Resources Department. The OPF should contain:

- The employees' background investigation form (this form is now kept in the DCPS Office of the Division of School Security due to the sensitive nature of the information contained in this form),
- A job application form,
- A completed W-4 form signed by the employee,
- An INS form 1-9,
- A copy of social security card, and
- Other relevant documents to support grade and/or step increases.

We randomly selected 56 DCPS employees and requested their Official Personnel Folders and 60 time sheets for review. During our review, we noted the following exceptions:

- Eight folders were missing a copy of the employee's Social Security Card,
- Eight folders were missing the employee's Employment Application,
- Ten folders were missing the employee's W-4, and
- Five folders were missing the employee's INS form 1-9.

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Criteria:

The District Personnel Manual Issuance System, DPM Bulletin No. 3 1-B-1, requires that all OPFs be reviewed, on an annual basis, to ensure retention of all key documents in an employee's OPF .

Cause:

DCPS did not consistently follow the requirement of DPM Bulletin No. 3 1-B-1.

Effect:

Missing and/or incorrect file documents can result in the incorrect processing of employee payroll relative to an employee's earnings, payroll deductions, and net salary.

Recommendation:

- All pertinent documents for an OPF should be obtained in a timely manner during the employment process and retained in the OPF.
- DCPS should perform an annual review of its personnel files to ensure that each file is updated to reflect all required documents including the Personnel Action Forms.

Management's Response:

The Office of Human Resources is aware of the need to improve the maintenance and monitoring of records, consequently, we have taken steps to correct this situation.

Personnel files are being scanned for automation and more efficient accessibility. As a part of this process, folders are removed from shelves for shipment and returned weekly. In the interim, additional employee information is forwarded to the Records Room. Items that have not been scanned are sorted and placed in a separate holding area for shipment at a later date. We are currently working to label returned folders, placing them back on the shelves and packaging additional folders for scanning. Therefore, some of the later submissions forwarded to the Records Room were not available for review.

To complete this task, temporary employees are being engaged to assist the current staff.

00-3: Capital Leases not properly recorded

Since 1997, fixed assets acquired under a capital lease with one of DCPS' contractors were recorded as additions to the fixed assets only to the extent that lease payments were made. This is contrary to Statement of Financial Accounting Standards No. 13 that requires recording of capital lease as an asset and an obligation at an amount equal to the present value of minimum lease payments at the beginning of the lease term.

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Criteria:

Statement of Financial Accounting Standards No. 13 was not followed.

Effect:

Fixed assets accumulated depreciation, were understated in the General Fixed Assets Account Group and the General Long-term Debt Account Group was also understated.

Recommendation:

DCPS should establish accounting policies and procedures to record all fixed assets acquired under capital leases in accordance with Statement of Financial Accounting Standards No. 13.

Management concurs with this finding. Beginning immediately, we will record all fixed assets acquired under capital leases in accordance with Statement of Financial Accounting Standards No. 13.

00-4: Inadequate Internal Audit

The Internal Audit Division is not adequately staffed to efficiently perform the required functions for DCPS. The division is staffed with only one Director whose activities for FY 2000 included:

- Serving as a team member of the DCPS committee to resolve issues,
- Acting as the liaison between the Superintendent and the DC OIG relating to audit and investigative inquiries,
- Performing internal audits and investigations, and
- Working with USDA regarding the audit of federal requirements and procurement practices.

Criteria:

The internal audit function is a necessary component of a strong internal control system for an agency the size and complexity of DCPS.

Effect:

The scope of the internal audits was not reasonably comprehensive to meet normal internal audit objectives.

Recommendation:

The division should be staffed with adequate and competent audit staff to function and meet DCPS' internal audit objectives.

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Management's Response:

Management concurs with this finding. DCPS will take the necessary steps to recruit and hire additional auditors to staff the Internal Audit Department.

00-5: Inadequate Processing of Invoices

Several instances of inadequate internal controls over payment processing were noted during our testwork.

1. A duplicate payment of approximately one million dollars was made as a result of a replacement check being issued by the D.C. Office of Finance and Treasury (OFT) without ensuring that the earlier check had not previously cleared the bank.
2. Invoices processed for payment were not effectively cancelled;
3. Payments were processed based on photo/fax copies invoices; and
4. Invoices were not stamped for date of receipt.

Cause:

For the first item, D.C. OFT did not confirm with the bank that the original check had not cleared the bank before issuing the replacement check. The other items result from a lack of training and supervision.

Recommendations:

DCPS should ensure that all staff are properly trained and have access to documented procedures that address, among other things, that:

- Vendor payments should be made only upon receipt of an original invoice, which should comply with terms of the applicable contract regarding certification by the vendor and be approved by authorized personnel within DCPS.
- All invoices should be effectively cancelled once processed for payment.
- Replacement checks should be issued to a vendor only after confirming that the original check had not cleared the bank and after a stop payment on the earlier check is placed with the bank. Consideration should be given by the Office of the Treasurer to allow DCPS access to information regarding checks issued by the Office of the Treasurer on their behalf.
- Vendor invoices should be stamped when received to improve the documentation of compliance with the Quick Payment Act.

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Management's Response:

After being notified by the vendor that they had not received the check, DCPS' Finance Division followed the standard procedure and prepared a Stop Payment/Reissue Check Request Form, which was submitted to the City Treasurer's Office. Responsibility for issuing the stop payment order to the bank, confirming that the check was not cashed and issuing a replacement check lies with the City Treasurer's Office.

It is a documented standard requirement to only make payments on properly authorized original invoices and to stamp these invoices "PAID" immediately after processing the payment. We will reiterate to our Accounts Payable staff the standards processing requirements for vendor payments.

00-6: Emergency Payroll Procedures Were Circumvented

DCPS implemented a new payroll system effective October 1, 1999 (CAPPS). Because of implementation problems, hundreds of DCPS employees were not receiving correct paychecks. To streamline the process for issuing corrected checks to the employees, DCPS received authorization to establish an on-site help desk to approve and issue supplemental checks from DCPS funds. The help desk was to work in coordination with the D.C. Office of Pay and Retirement Services (OPRS). When a request for supplemental check was received, DCPS would notify OPRS and OPRS, in turn, would enter the necessary information into CAPPS to ensure that the check amount and related withholdings were properly calculated and that the employee record was properly updated. DCPS would subsequently be reimbursed for checks issued.

Because of the volume of supplemental check requests, DCPS did not always follow the process of coordinating with OPRS. As a result, DCPS issued checks to employees that were not recorded in CAPPS. Requests for reimbursement were denied because OPRS was not provided adequate support for checks issued. Between October and December 1999, approximately \$1.1 million in emergency payroll checks were not reimbursed.

Effect:

Circumventing the established procedures had a domino effect:

1. The payroll information was not recorded in CAPPS causing the 1999 Gross Pay and Federal and State withholding deductions reported on the W-2s issued to the affected employees to be understated by the amounts paid out of the DCPS imprest account.
2. OPRS could not validate, and therefore approve, the requests for reimbursement from DCPS.
3. The DCPS imprest funds were overdrawn.
4. DCPS borrowed from the Central Investment Funds (CIF) and had not made repayment at September 30, 2000 (see finding 00-7). As a result, restricted funds set aside for restricted purposes were used for emergency payroll payments which were not reimbursed on a timely manner.

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Recommendation:

DCPS has discontinued the emergency process. They should provide the necessary documentation to OPRS to support the reimbursement request. The CIF account should be replenished.

Management's Response

Management concurs with this finding. On numerous occasions DCPS requested that the District reimburse the DCPS payroll imprest fund for amounts disbursed. The standard procedure for reimbursement would include processing all transactions in the CAPPs payroll system and issuing amended W-2s for 1999. To date, these transactions have not been processed.

00-7: Restricted Funds used for Other Purposes

CIF established for restricted purposes were used by DCPS to fund emergency payroll checks issued to employees of DCPS. According to DCPS, funds advanced from the CIF account to the payroll imprest account were to be repaid within a short period.

In early December 1999, DCPS submitted the necessary documents to the District so that the checks advanced from the payroll imprest account could be processed within CAPPs (see Finding 00-6). This would have triggered the reimbursement to the payroll imprest account at which time the CIF account would have been reimbursed. However, there is disagreement between DCPS and OPRS as to the adequacy of the documentation submitted.

Cause:

The imprest payroll checks were not properly processed to allow for reimbursement in a timely manner. Therefore, CIF were used to cover the shortfall in the imprest account.

Effect:

Restricted funds were used for other than the designated purpose. Further, the CIF account specifically designated for the benefit of DCPS earns interest on the amount invested. However, when these funds are co-mingled with funds of other DC government agencies the interest earned on pooled funds is not distributed under the District's current regulations. As a result, the CIF did not earn any interest on the funds advanced to the payroll imprest account.

Recommendation:

We recommend that the necessary actions be taken immediately to reimburse the CIF accounts. Procedures should be established to ensure that restricted funds are used only for the designated purpose.

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Management's Response:

Management agrees with the finding. The funds were temporarily borrowed for a payroll emergency and were to be reimbursed within a short period of time. DCPS submitted reimbursement requests to the District, however reimbursement has not been made. The Inspector General has DCPS' check copies and other supporting documents in its possession. We have contacted the Inspector General and requested the return of our supporting documents. Immediately after the documents are returned, we will resubmit a request for reimbursement.

00-8: Payroll Allocation

Certain categories of employees within DCPS are chargeable to DC appropriated funds as well as Federal and private grants. In order to allocate payroll and related personnel costs to the related Federal and private grants, the following procedures are currently being performed:

- The affected schools submit to DCPS payroll manually prepared summaries approved by the principals that indicate the names of the employees and the amounts to be charged to each Federal and private grant.
- The manually prepared spreadsheets are reviewed for accuracy and completeness by the payroll department.
- Two accounting technicians within the Finance Department then enter the total distribution from each of the manually prepared spreadsheets into a summary Excel spreadsheet containing all schools and/or programs.
- The summarized spreadsheet is then used as a basis for preparing a reclassifying journal entry to allocate the payroll to the respective Federal and private grants.

During the fiscal year ended September 30, 2000, there were only three summarized payroll allocation spreadsheets that were used to allocate the payroll for the entire year.

Cause:

Presently, the District's payroll system (CAPPS) does not allocate employees' payroll to more than one fund at the time each payroll is processed.

Effect:

Draw downs off Federal funds related to expenditures for personnel costs were not performed in a timely manner.

Recommendation:

- OFOS should explore the possibility of fully utilizing the function within CAPPS that allows the allocation of an employee's payroll costs to multiple SOAR accounts.

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- In the interim, we recommend that DCPS consider implementing a policy that requires the principals to electronically submit the detailed schedules, on computer generated spreadsheets, to the payroll department each pay period. The spreadsheets should be forwarded to the Finance Department where they can be linked, electronically, to the summary spreadsheet thereby facilitating an easy calculation of the payroll allocation.

Management's Response:

Management concurs with this finding. The optimum solution is to fully utilize the capabilities of the automated system to distribute payroll costs to the proper program. However, until that solution is in place, DCPS will consider requiring principals and department heads to electronically submit detailed schedules on computer generated spreadsheets each pay period. The process would facilitate the payroll allocation.

00-9: Monitoring of Expenditures

The statement of expenditures generated by SOAR compares year-to-date actual expenditures to the current budget amounts. Inconsistencies between the location of budget in the account structure and the expenditures with which they are intended to be associated hinder the effective monitoring of spending. Delays in the loading of budget until well into the fiscal year contribute to the difficulties in monitoring expenditures as they require the use of temporary funding sources and may have the effect of artificially inflating the rate of expenditure.

While the unexpended portion of a particular category is useful to the budget department in allocating expenditures to unexpended budget categories, it is not effective in identifying budget and expenditure inefficiencies, because, in the earlier months of any given fiscal year, departments may be spending at a much higher annual rate than budgeted and budget overruns would not be detected until the latter months of the fiscal year when the unspent portion of the budget category approaches zero.

Cause:

The budget is not loaded in sufficient detail to allow for efficient monitoring of expenditures, and detail budgets are not loaded at the start of the fiscal year.

Recommendation:

Because the delays in loading parts of the operating budget may be unavoidable, we recommend that DCPS consider quarterly reports that compare the prior year's year-to-date expenditures as a percentage of the prior year's budget to the current year's actual year-to-date expenditures as a percentage of the current year's budget. Potential areas of operating inefficiencies can then be determined early enough to take necessary corrective action.

The Internal Audit Department can investigate major variances reflected in such reports to determine whether the variances are consistent with the prior year's underlying budget assumptions and document the

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explanations for the major variances. The internal audit department should follow up on unexplained variances and appropriate action, including budget modifications, should be taken as necessary.

Management's Response:

Management concurs with this finding. We will implement the quarterly reports recommended beginning with the quarter ended March 31, 2001. Instead of the Internal Audit Department performing an analysis of the budget to actual variances, we will assign that responsibility to an accountant who will work closely with the Budget Analyst responsible for the area where the variance is noted to adequately explain the variance.

00-10: Budget Tracking

SOAR has built-in controls that limit expenditures for a given fiscal year to the amount budgeted for expenditures in particular object classes such as supplies and materials, utilities, and telecommunications for each department, program, or school. The tracking of actual expenditures versus budgeted amounts is determined based on how the budget is loaded into the system. In situations in which funds were loaded and expenditures were charged to object 41, Negotiated Services Contracts, no additional detail is included in the system beyond the object level. In contrast, other objects allow for sub-object and commodity code detail, which enables more precise tracking and reporting of expenditures.

We noted the following instances in the programming of DCPS' budget that could improve the efficiency of processing and tracking expenditures at DCPS. Currently DCPS program budget category "contractual services" may include any type of acquired goods and services without distinguishing among contracts entered for the leasing of equipment, contracts to provide security services, acquisition of equipment, utilities, or other natural class expenditures "object code".

Effect:

Programming the budget in such a broad manner does not allow for efficient monitoring of the less broad categories.

Recommendation:

As appropriate, DCPS should take advantage of the additional detail available in objects other than 41 and minimize usage of this object. DCPS should load its budget accordingly.

Management's Response:

Management concurs with this finding and will take the necessary steps to minimize the use of object level 41 when loading future budgets.

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00-11 Physical Inventory Not Performed

We noted that a comprehensive physical inventory of all personal property was not performed by DCPS during fiscal year 2000.

Criteria:

Per Directive 643.7 Equipment Management Accountable Property Guidelines, dated April 17, 1992, "physical inventories of all personal property should be made at least annually by each school, division, and office."

Cause:

DCPS did not comply with directive 643.7.

Effect:

The property records may not accurately reflect the inventory of personal property.

Recommendation:

- DCPS should take the necessary steps to ensure that physical inventory of all personal property be taken on an annual basis in compliance with Directive 643.7.
- DCPS should ensure that the property records are reconciled with the physical inventories and the necessary adjustments made to the general fixed assets group of accounts.

Management's Response:

Management concurs with this finding. This is a District-wide issue and OFOS has recently initiated implementation of the fixed assets module within SOAR.